

Message Text

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ACTION EUR-12

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TO SECSTATE WASH DC IMMEDIATE 5765

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FOR UNDER SECRETARY ROBINSON

E.O. 11652: N/A

TAGS: ETRD, OECD

SUBJECT: XCSS: SECRETARIAT PAPER ON COMMODITIES

REF: PARIS OECD 5741

1. FOLLOWING IS TEXT OF DRAFT SECRETARIAT PAPER
"POSSIBLE OECD ACTION IN AREA OF INDUSTRIAL RAW MATERIALS" PREPARED FOR RESTRICTED XCSS MEETING MARCH 10.
DEPARTMENT SHOULD TREAT WITH DISCRETION AS IT IS STILL
POSSIBLE SECGEN WILL DECIDE NOT TO DISTRIBUTE IT AT
MEETING.

2. BEGIN TEXT: 1. THE OECD HAS DISCUSSED, ON A NUMBER
OF OCCASIONS, THE IMPORTANCE OF AVOIDING A REPETITION,
IN THE NEXT ECONOMIC UPTURN, OF THE DRAMATIC RISE OF
COMMODITY PRICES THAT MARKED 1973-74. WHILE THE STEEP-
NESS OF THAT PARTICULAR BOOM WAS CERTAINLY, IN PART,
THE RESULT OF CERTAIN SPECIFIC FACTORS - INCLUDING THE
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INSTABILITY THAT HAD DEVELOPED IN THE INTERNATIONAL

MONETARY SYSTEM - IT SEEMS ALSO TO HAVE RESULTED FROM THE WAY THE COMMODITY MARKETS HAD BEEN MOVING IN THE PREVIOUS YEARS. PRICES OF MANY INDUSTRIAL RAW MATERIALS HAD BEEN DEPRESSED DURING A LONG PERIOD AND EXPECTATIONS HAD BUILT UP THAT THEY WOULD REMAIN SO. THERE IS EVIDENCE THAT THIS LED TO UNDERINVESTMENT DURING THE LATER '60S AND EARLY '70S IN SEVERAL BASE METAL INDUSTRIES AND IN PETRO-CHEMICALS DIRECTLY COMPETING WITH NATURAL FIBRES AND RUBBER. MORE IMPORTANTLY, THE WIDESPREAD SHORTAGES THAT OCCURRED IN 1973 WERE EVIDENCE OF INADEQUATE STOCKS IN THE HANDS OF USERS WHO WERE UNABLE TO COPE WITH A SUDDEN SURGE OF DEMAND AT A MOMENT WHEN PRODUCTION CAPACITY WAS FULLY USED. THE 1965-66 AND 1968-69 ECONOMIC UPSWINGS, WHICH WERE LESS PRONOUNCED BUT CORRESPONDED TO A HIGHER LEVEL OF OVERALL CAPACITY UTILISATION, HAD REVEALED NO SUCH BOTTLENECKS IN THE PRIMARY INDUSTRIES.

2. IT WAS WITH THESE CONSIDERATIONS IN MIND THAT, IN FEBRUARY 1974 THE ECONOMIC POLICY COMMITTEE CONCLUDED THAT, FROM THE POINT OF VIEW OF COMBATING INFLATION, GREATER CONSIDERATION SHOULD BE GIVEN TO THE NEEDS OF PRICE STABILITY WHEN INTERNATIONAL COMMODITY POLICIES WERE BEING FRAMED. IN A NOTE PRESENTED BY THE SECRETARY GENERAL TO THE EXECUTIVE COMMITTEE IN SPECIAL SESSION ON 18TH-19TH MARCH 1974 (CE(74)5), ATTENTION WAS DRAWN TO THE HARMFUL EFFECTS OF EXCESSIVE PRICE FLUCTUATIONS ON PRIMARY PRODUCT MARKETS ON THE WORLD ECONOMY AS A WHOLE AND MEMBER COUNTRIES IN PARTICULAR. THE NOTE SUGGESTED THAT THE NEED MIGHT ARISE FOR ACTION SO THAT COMMODITY PRICES WOULD NOT "DECLINE FREELY IN THE WAKE OF ANY WEAKENING IN MARKETS THAT MIGHT TAKE PLACE". IT EXPLORED FORMS OF POSSIBLE ACTION BY THE OECD AND, PARTICULARLY IN PARA. 18, SUGGESTED "THE INITIATION OF STUDIES OF THE FEASIBILITY OF BUILDING UP LARGER STOCKS OF KEY COMMODITIES WHEN SUPPLIES IMPROVE". IN MAY, MINISTERS ENDORSED THE EXECUTIVE COMMITTEE'S SUGGESTION THAT, IN ITS WORK ON COMMODITIES, OECD SHOULD SEEK TO IDENTIFY POLICIES MORE CONDUCTIVE TO GENERAL PRICE STABILITY.

3. THE SECRETARY GENERAL'S NOTE WAS BASED ON THE LIMITED OFFICIAL USE

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EXPECTATION THAT INDUSTRIAL RAW MATERIAL PRICES, WHICH ARE STONGLY LINKED TO THE LEVEL OF OECD ECONOMIC ACTIVITY, WOULD WEAKEN AS THE CONDITIONS OF EXCESS DEMAND DISSIPATED. IN THE EVENT, THE UNEXPECTEDLY SHARP DROP IN AGGREGATE DEMAND IN THE CLOSING MONTHS OF 1974 AND THE ENSUING INVENTORY LIQUIDATION IN A NUMBER OF COUNTRIES HAVE PUT INDUSTRIAL RAW MATERIAL PRICES UNDER SEVERE PRESSURE. BY JANUARY 1975 THESE PRICES HAD

FALLEN BACK TO THEIR JANUARY 1973 LEVELS. THE DROP IN INDUSTRIAL RAW MATERIAL PRICES WOULD HAVE BEEN EVEN MORE SEVERE HAD IT NOT BEEN FOR CUTBACKS IN SUPPLY (IN MARKET SALES OR EVEN PRODUCTION). WHILE THE RECENT INCREASED EMPHASIS ON FORMING PRODUCERS ASSOCIATIONS HAS SO FAR BEEN LARGELY DEFENSIVE, IT COULD LAY THE GROUNDWORK FOR MORE AGGRESSIVE CARTEL ACTION DURING THE NEXT CYCLICAL UPSWING. THE FALL IN NOMINAL PRICES HAS BEEN ACCOMPANIED BY A SHARP RISE IN COSTS OF PRODUCTION, THE EFFECT OF WHICH WAS AGGRAVATED BY

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THE PRESSURE ON COST STRUCTURES EXERTED THROUGH LESS THAN OPTIMUM CAPACITY UTILISATION AND THE BURDEN OF FINANCING PRODUCERS' STOCKS. THERE IS EVIDENCE OF THE STRETCHING OUT OF CURRENT INVESTMENT PROJECTS AND CANCELLATIONS OF ADDITIONS TO CAPACITY, WHICH IF, GENERALIZED, COULD JEOPARDISE FUTURE SUPPLY.

4. IN CONTRAST TO INDUSTRIAL MATERIALS, THE BASIC SUPPLY SITUATION IN MAJOR FIELD CROPS (IN PARTICULAR CEREALS AND SUGAR) REMAINS TIGHT AND PRICES, THOUGH WELL BELOW THEIR PEAKS ARE STILL QUITE HIGH. ALTHOUGH SOME COMMODITIES (E.G. COFFEE AND TEA AND MEAT) HAVE NOT BENEFITED FROM THE RUN-UP IN FOOD PRICES, THE UNDERLYING SITUATION IN THE FOOD SECTOR DIFFERS APPRECIABLY FROM THAT PREVAILING FOR INDUSTRIAL RAW MATERIALS.

5. THE PREOCCUPATION WITH THE OUTLOOK FOR COMMODITY MARKETS HAS ENCOURAGED DEMAND FOR THE INCLUSION OF NON-OIL COMMODITY PROBLEMS IN THE AGENDA OF THE DIALOGUE BETWEEN OIL PRODUCERS AND CONSUMERS, AND FOR AN LIMITED OFFICIAL USE

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"INTEGRATED PROGRAM FOR COMMODITIES" IN UNCTAD. THIS AMBITIOUS PROGRAM ENVISAGES INTER ALIA THE GENERALISATION OF BUFFER-STOCKS AND LONG-TERM CONTRACTS. IRRESPECTIVE OF ITS MERITS, IT COULD HARDLY BE NEGOTIATED AND IMPLEMENTED IN TIME TO AFFECT COMMODITY PRICE BEHAVIOR IN THE PRESENT DOWNTURN.

6. THERE HAVE BEEN SOME RECENT INITIATIVES BY OECD COUNTRIES TO ESTABLISH NATIONAL STOCKPILE SCHEMES OR TO FACILITATE STOCKPILING BY PRODUCERS OR INDUSTRIAL USERS. THOUGH NOT LARGE BY THEMSELVES, THESE INITIATIVES INDICATE A RECOGNITION OF THE EMERGING PROBLEM.

7. WITH THE PROSPECT OF A FURTHER WEAKENING OF CERTAIN COMMODITY MARKETS IN THE IMMEDIATE FUTURE, IT WOULD SEEM IMPORTANT FOR MEMBER GOVERNMENTS TO CONTEMPLATE SOME REINFORCEMENT OF THE ACTIONS THAT A FEW OF THEM HAVE TAKEN IN RECENT MONTHS. THE FOLLOWING PARAGRAPHS OUTLINE, IN VERY BROAD TERMS, THE PURPOSE, METHOD AND SCOPE OF SHORT-TERM MEASURES - BASED ON SOME COORDINATION OF NATIONAL POLICIES - TO PREVENT SERIOUS FURTHER FALLS IN CERTAIN COMMODITY PRICES. CONCEIVED AS A MEANS OF TACKLING RATHER QUICKLY AN EMERGENCY SITUATION, THEY DO NOT SEEK TO ESTABLISH POLICIES WHICH, OVER THE LONGER TERM, COULD HELP ENSURE A SUITABLE RESPONSE ON THE SUPPLY SIDE TO THE WORLD'S EVOLVING NEEDS FOR PRIMARY COMMODITIES; BUT FAR FROM PRECLUDING LONGER-TERM ACTION, THEY COULD HELP TO PREPARE THE GROUND FOR IT.

8. THE PURPOSE OF SUCH MEASURES WOULD BE TO REDUCE MARKET INSTABILITY, BY PREVENTING AT THE PRESENT JUNCTURE A COLLAPSE OF COMMODITY PRICES OR EXCESSIVE REDUCTIONS OF OUTPUT - DEVELOPMENTS THAT COULD THREATEN EVENTUALLY TO PERPETUATE THE CIRCUMSTANCES THAT MARKED THE 1973-1974 COMMODITY BOOM. THE PROPOSALS ARE PUT FORWARD STRICTLY FROM AN OECD ECONOMIC VIEWPOINT, IN THE INTEREST OF MEMBER COUNTRIES AS COMMODITY PRODUCERS AND AS CONSUMERS. BUT THEIR POSSIBLE EFFECTS MIGHT GO

BEYOND THESE INTERESTS. BY CUSHIONING THE EFFECTS OF THE CURRENT RECESSION ON THE FLOW OF REAL INCOME OF COMMODITY PRODUCERS, THEY WOULD ENSURE THAT EFFECTIVE DEMAND FOR OECD EXPORTS WAS BETTER MAINTAINED AND, THUS, INCIDENTALLY HELP PREVENT A CUMULATIVE DOWNTURN IN LIMITED OFFICIAL USE

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ACTIVITY.

9. THE MEASURES ENVISAGED COULD TAKE THE FORM OF SUPPORT BUYING AT AGREED FLOOR PRICES, BY CONSUMING COUNTRIES UNILATERALLY. ALTERNATIVELY, THEY COULD TAKE THE FORM OF SHORT-TERM AD HOC COMMODITY AGREEMENTS BETWEEN PRODUCERS AND CONSUMERS WITH EACH SIDE FOOTING HALF THE COST. (FOOTNOTE : FOR RELATIVELY HOMOGENEOUS COMMODITIES WITH NO CLOSE SUBSTITUTES NOT PRODUCED WITHIN THE OECD (IN PRACTICE ONLY TROPICAL BEVERAGES FALL INTO THIS CATEGORY), ONE COULD ENVISAGE A SYSTEM OF VARIABLE LEVIES RAISED BY IMPORTING COUNTRIES AND REFUNDED TO EXPORTERS.) THE ESSENCE OF THE PROPOSALS WOULD BE THAT, WHETHER ACTING INDIVIDUALLY OR THROUGH A CENTRAL BUYER, PURCHASERS WOULD ENSURE THAT PRICES DID NOT SINK BELOW A RATHER LOW FLOOR, BUT THAT THEY WOULD BE FREE TO CONSUME OR SELL THEIR STOCKS GRADUALLY WHEN THE FLOOR PRICE WAS EXCEEDED. (FOOTNOTE: THE FLOOR PRICES ENVISAGED IN THE EMERGENCY MEASURES WOULD HAVE TO BE QUITE LOW BY HISTORICAL STANDARDS - POSSIBLY AROUND THE LOWEST SPOT QUOTATIONS ACTUALLY REGISTERED IN THE PAST FIVE YEARS. THERE WOULD THUS BE NO INCENTIVE FOR INCREASING PRODUCTION IN THE SHORT RUN AND ONLY A LIMITED RISK THAT EXISTING USERS' STOCKS WOULD BE UNLOADED ON THE MARKET.) SUCH ACTION WOULD COMPLEMENT EFFORTS ALREADY MADE BY PRODUCERS TO

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ESTABLISH BUFFER STOCKS AND WOULD BE AN ECONOMICALLY PREFERABLE ALTERNATIVE TO CUTBACKS OF PRODUCTION AND, EVENTUALLY, OF INVESTMENT.

10. A PRELIMINARY ASSESSMENT BY THE SECRETARIAT SUGGESTS THAT SUPPORT BUYING MIGHT BE NECESSARY AND FEASIBLE FOR A RELATIVELY LIMITED RANGE OF EASILY STORABLE INDUSTRIAL RAW MATERIALS (BASE METALS, FIBRES AND RUBBER) AND POSSIBLY SOME TROPICAL BEVERAGES. THIS WOULD INVOLVE 7-12 MAJOR COMMODITIES TRADED ON THE OPEN MARKET, ACCOUNTING FOR 3-5 PER CENT OF TOTAL OECD IMPORTS. THE TOTAL FINANCIAL COMMITMENT WOULD RANGE BETWEEN \$2 AND \$4 BILLION (OF WHICH ONE-HALF WOULD BE BORNE BY PRODUCERS). HOWEVER, GIVEN THE FACT THAT SUPPORT BUYING WOULD ONLY TAKE PLACE AT VERY LOW FLOOR PRICES, THE ACTUAL COST WOULD BE UNLIKELY TO EXCEED INTEREST CHARGES PLUS STORAGE COST (ESTIMATED AT \$250-350 MILLION PER ANNUM), SINCE ONCE THE UPTURN OF THE OECD ECONOMIES IS UNDER WAY AGAIN PRICES COULD BE EXPECTED TO RISE ABOVE THE FLOOR. (FOOTNOTE: THE LIMITED OFFICIAL USE

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EXISTENCE OF INTERNATIONAL COMMITMENTS TO PREVENT PRICES FROM FALLING BELOW A REALISTICALLY SET FLOOR COULD INCITE INDUSTRIAL USERS TO REFRAIN FROM UNLOADING THEIR NORMAL WORKING STOCKS. THIS WOULD LIMIT THE NEED FOR ACTUAL INTERVENTION.) COUNTRIES IN DIFFICULT BALANCE OF PAYMENTS SITUATIONS (BOTH PRODUCERS AND CONSUMERS) MIGHT, IN SUITABLE CIRCUMSTANCES, BE ABLE TO DRAW ON THE IMF FOR FINANCING. FURTHER DETAILS ABOUT THE POSSIBLE ORDERS OF MAGNITUDE AND TECHNICAL ISSUES ARE AVAILABLE IN A BACKGROUND NOTE. (MISSION COMMENT:

STATUS OF PREPARATION OF THIS NOTE UNKNOWN.)

11. PRICE STABILISATION SHOULD NOT BE VIEWED AS A FORM OF INCOME MAINTENANCE OF DEVELOPING COUNTRIES AS SUCH AND THE PRESENT PROPOSALS ARE NOT PUT FORWARD AS A MEANS OF INCOME TRANSFERS TO NON-OIL LDCS. INDEED, THE POOREST MEMBERS OF THE INTERNATIONAL COMMUNITY ARE UNLIKELY TO DERIVE MUCH BENEFIT FROM COMMODITY PRICE STABILIZATION. THE PLIGHT OF THESE COUNTRIES CAN ONLY BE ALLEVIATED BY EFFECTIVE AID PROGRAMS. NEVERTHELESS, DEVELOPING COUNTRIES WITH A LARGE RESOURCE BASE WOULD BE RELIEVED OF EXTREME BALANCE OF PAYMENTS STRAINS AND INCOME-EMPLOYMENT LOSSES. THIS COULD MAKE A MATERIAL CONTRIBUTION TO IMPROVING THE ATMOSPHERE FOR THE DIALOGUE BETWEEN INDUSTRIAL AND DEVELOPING COUNTRIES.

12. SUPPORT BUYING OF THIS NATURE WOULD NOT CONSTITUTE MORE THAN A HOLDING OPERATION. AS SUCH IT WOULD NOT REMOVE THE NEED FOR GOVERNMENTS TO THINK THROUGH THEIR INVESTMENT AND OTHER POLICIES, OVER THE LONGER-TERM, TO ASSURE ADEQUATE SUPPLIES OF INDUSTRIAL RAW MATERIALS AT REASONABLY STABLE PRICES, WITHOUT ENGENDERING LARGE MARKET DISEQUILIBRIA. BUT IT COULD HELP TO BRIDGE THE PERIOD BEFORE SUCH POLICIES HAD BEEN WORKED OUT.

13. ONE POSSIBLE PROCEDURE MIGHT BE FOR MEMBER GOVERNMENTS TO CONSIDER THE OPPORTUNITY OF FORMALLY DECLARING THEIR INTENTION TO PREVENT A COLLAPSE OF PRICES AND/OR EXCESSIVE REDUCTION OF OUTPUT THAT COULD LEAD TO FUTURE SUPPLY SHORTAGES FOR SEVERAL IMPORTANT COMMODITIES, NOTABLY INDUSTRIAL RAW MATERIALS. SUCH A DECLARATION OF INTENT, OR PLEDGE, MIGHT INCLUDE THE ACCEPTANCE OF TWO PRINCIPLES: (A) UNDERTAKING UNILAT-LIMITED OFFICIAL USE

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ERAL BUT COORDINATED NATIONAL STOCKPILING ACTIONS, AND (B) PARTICIPATING IN THE NEGOTIATIONS OF AD HOC EMERGENCY COMMODITY AGREEMENTS BETWEEN PRODUCERS AND CONSUMERS IN APPROPRIATE CASES. SUCH A DECLARATION COULD PROVIDE THE POLITICAL IMPETUS AND A BROAD FRAMEWORK FOR EMERGENCY ACTION. INDIVIDUAL COUNTRIES' COMMITMENTS WOULD HAVE TO BE WORKED OUT IN AN APPROPRIATE FORUM. END TEXT
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